fraction of the costs of the lines they use to connect to the PSTN.[52] Second, the ILECs ask the Commission to believe that the tremendous growth in residential second lines during the last few years has not been caused by the growth of consumer demand for access to the Internet and information services.[53] Finally, the ILECs insist that revenue from second lines used to provide these services does not cover the cost of the lines.[54]

**ESPs/ISPs are paying compensatory rates for their use of local access lines.** Bell Atlantic repeats the contention, first advanced in its 1996 "congestion" study, that it is losing significant amounts of money by providing service to ESPs/ISPs. According to the carrier, ESPs/ISPs that use line-side connections (such as business lines) to attach to the PSTN pay approximately $20 per channel per month, but generate costs of $75 per channel per month. ESPs/ISPs that use trunk-side connections (such as T-1s or ISDN lines), the carrier further asserts, pay approximately $23 per channel per month, while generating costs of $50 per channel per month.[55]

Bell Atlantic's method for estimating the cost of an ESP/ISP line-side connection is deeply flawed. The carrier invents the $75 figure for these connections by allocating a disproportionate share of the line concentration unit ("LCU") to each ESP/ISP access line. The

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52 See Bell Atlantic/NYNEX Comments at 10; Pacific Comments at 31; GTE Comments at 23.

53 See Bell Atlantic/NYNEX Comments at 11; USTA Comments, AEI Affidavit, at 37, 38.

54 See Pacific Bell Comments at 32; USTA Comments, AEI Affidavit, at 50; SWBT Comments at 11; GTE Comments at 24.

55 Bell Atlantic Comments, Attachment B, at 1.

LCU is a central office-based device that allows a large number of subscriber lines to share a smaller number of paths through the ILEC's switch. At ordinary traffic levels, an LCU can accommodate up to 450 subscriber lines during the busiest hour. Bell Atlantic, however, estimates that the average ESP/ISP line has a far higher level of use than other lines.[56] As a result, Bell Atlantic contends, an LCU can only accommodate about 65 ESP/ISP subscriber lines. Bell Atlantic therefore allocates seven times more of the cost of the LCU to ESP/ISP lines than it does to standard voice lines.[57]

Bell Atlantic overlooks a significant fact: the peak hour for ESP/ISP lines is not the same as ordinary voice lines. Rather, according to Bell Atlantic's own study, usage is low during business hours, but peaks between 11 PM and midnight.[58] Because relatively few other callers are using the network at that time, however, the carrier does not have to deploy a significant number of additional LCUs to handle this traffic. Rather, it can -- and presumably does -- accommodate a significant portion of the ISP traffic by using the same LCU to serve a mixture of ISP business lines and subscriber lines that have a different busy hour. Bell Atlantic is generating an artificially high cost estimate by allocating to ESP/ISP line-side connections the cost of "phantom" LCUs that, in reality, it will never deploy.[59]

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56 See Bell Atlantic Study on Internet Traffic at 6 (1996).

57 Id. at 8.

58 Id. at 6.

59 US West similarly refuses to acknowledge that calls outside the busy hour do not increase network costs. The carrier concedes that "[a]s long as the ESP busy hour is not the same hour and has less usage than the [business] . . . busy hour, a long run incremental cost (continued...)

Bell Atlantic's estimate that ISDN connection used by ESPs/ISPs cost $50 per channel is even harder to fathom. An ILEC that provides a trunk-side connection agrees to reserve a specific amount of network capacity for the subscriber, regardless of whether the subscriber is using that capacity at any given moment. Because the capacity is reserved, Bell Atlantic has no basis to argue that the extent to which an ESP/ISP (or any other subscriber) uses an ISDN line significantly increases the cost of the line. The carrier provides no explanation whatsoever as to why it has chosen to price ISDN lines at $23 per channel if it believes that this rate is not compensatory for all customers.

Pacific's claim that it, too, is losing money on ESPs/ISPs is even less convincing. Pacific asserts that it will spend over $300 million to support ESP/ISP traffic over the next five years, while generating only $150 million in revenues.[60] It further claims that the net present value of its anticipated losses over the next decade equals $440 million.[61] Yet, the carrier provides no explanation of how it arrived at these figures. It appears that Pacific has significantly over-estimated the amount of traffic that ESPs/ISPs will generate,[62] while

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[59](...continued)
study would not reflect that additional investments in the office are required to handle the ESP traffic." U S West Comments, Exhibit A, at 7. Yet, U S West asks the Commission to believe that -- for some unexplained reason -- it "could quite possibly" have to make additional investments to accommodate the growth of data traffic. Id. The Commission should give no weight to such unsupported speculation.

[60] See Pacific Comments at 31; id., Exhibit A, at 17.

[61] See id., Exhibit A, at 20.

[62] Pacific assumes that the average subscriber will stay on line for approximately 22.5 hours per month. See id., Exhibit A, at 6. This estimate is significantly higher than the (continued...)

disregarding substantial amounts of revenue that it will generate from information service users. Even under its own assumption, however, direct revenues from ESPs/ISPs will exceed costs in the year 2000. The following year, direct revenues from ESPs/ISPs are estimated to be twice Pacific's projected costs.[63]

**ILECs obtain significant revenues from information service customers.** As the Coalition explained in its comments in the Access Charge proceeding, the telephone network -- like the postal service -- is based on the "sender pays" principle. As a result, a significant portion of the revenues that the ILECs generate from data traffic comes from charges paid by the ESPs/ISPs' customers.[64] The Coalition went on to demonstrate that a significant source of such revenue is the monthly charges paid by residential customers that obtain a second line in order to access the Internet or other information services.[65]

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[62](...continued)
estimate of 15 hours per month provided in the ETI Study, which was based on proprietary data provided by major on-line service providers. See ETI Study at 29 n.57. Pacific also assumes that the average ESP/ISP line is in use approximately 675 minutes per day. See Pacific Comments, Exhibit A, at 6. This level of throughput (without unacceptable blocking) only would be possible for an ESP/ISP with a significant number of access lines. This suggests that Pacific's estimates are based only on the larger ESPs/ISPs and, therefore, may not be typical of ESPs/ISPs as a group.

[63] See id. at 17.

[64] Contrary to the suggestion of some of the ILECs, see, e.g., Pacific Comments at 17, the Coalition is not advocating cross-subsidization of one service with revenue from another. The total cost of providing access to the Internet and other on-line services consists of the costs of moving data from the customers' premises to the ESPs/ISPs' premises. There is nothing inappropriate about the ILECs recovering the relevant costs from both parties to these communications.

[65] See Internet Access Coalition Comments, CC Docket No. 96-262, at 16 (filed Jan. 29, 1997).

The study prepared for the Coalition by ETI estimated that 43.5 percent of all second lines in use as of December 1995 are being used to access the Internet and other information services.[66] ETI provided detailed support for this estimate. ETI first observed that the unprecedented increase in demand for residential second lines since 1990 was almost perfectly correlated with the growth in demand for information services. ETI then assumed -- quite conservatively -- that only about half of the dramatic increase in demand for second lines during the 1990s was actually caused by consumers who obtained these lines primarily or exclusively to access information services.

USTA challenges this finding. The study that USTA commissioned, however, makes no effort to quantify the extent to which the growth in second line demand has been caused by the growth of the Internet and other information services. Rather, it simply lists a large number of reasons why people obtain second lines and asserts that there appears to be "no valid reason to assert that [any of] these second line subscribers even desire Internet access."[67] At least two of the USTA's largest members disagree. Bell Atlantic recently estimated as much as 30 percent of second-line use is Internet related.[68] And Pacific's Chairman and CEO, Philip J. Quigley, publicly stated that his company is "making money from the Internet" because it "creates a significantly stronger demand for a wide variety of . . . services that Pacific Telesis

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66 See ETI Study at 25-28.

67 USTA Comments, Robert F. Austin, "On the Adverse Effects of Continuing Temporary Cost Subsidies," Austin Communications Education Services ("Austin Study"), at 36, 37.

68 See R.J. O'Connor, "Net's Need for Phone system Fix Sparks Battle Over Whose To Pay," San Jose Mercury, WWW.SJMercury.Com. (Jan. 25, 1997).

provides." It is "no coincidence," he added, that "20 percent of our residential customers already have additional access lines."[69]

While Pacific acknowledges that the growth of the Internet has spurred consumer demand for residential second lines, the carrier insists that "[r]evenues from sales of second lines to subscribers have not produced enough additional revenues to cover the costs of accommodating Internet traffic."[70] According to Pacific, the average cost per residential subscriber line is $20.50 per month.[71] While it does not provide a specific figure, Pacific implies that the incremental cost of second lines is actually higher.[72] In contrast, the carrier claims, revenue from second lines used exclusively for Internet or information service access is only $14.50 per month.[73] The only time residential second lines are profitable, Pacific insists, is when customers use them to make long-distance calls (which generate access charge payments) or order vertical features (such as call waiting).[74]

The evidence suggests that Pacific is wrong. The $20.50 per month cost figure cited by the carrier appears to be based on the Proxy Cost Model ("PCM") that Pacific developed for the Universal Service proceeding. The PCM reflects Pacific's embedded costs

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69 Interview with Philip J. Quigley, Pacific Telesis - Inside Line. Pacific Telesis Home Page, www.pactel.com/financial/inside_line/il98.html (Feb. 5, 1997).

70 Pacific Comments at 5.

71 See id., Exhibit A, at 20.

72 See id. at 19.

73 See id. at 20.

74 See id. at 18.

for all residential lines.[75] Contrary to Pacific's assertion, logic suggests that the cost of residential second lines is lower than the average cost of all residential lines.[76] The proper means to estimate such costs, moreover, is to use a total element long-run incremental cost ("TELRIC") methodology.

In the Interconnection Order, the Commission concluded that the TELRIC cost of the local loop in California is $11.10 per month.[77] This figure includes loops deployed by GTE and the independent telephone companies -- many of which serve rural areas and, therefore, presumably have higher loop costs than Pacific. Nonetheless, for present purposes, the Coalition is prepared to assume the $11.10 figure is an estimate of the cost of each second line deployed by Pacific.

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75 See FCC Staff Analysis, The Use of Computer Models for Estimating Forward-Looking Economic Cost, ref. Jan. 9, 1997, at ¶ 39 (Pacific's estimate of loop costs is based on its Cost Proxy Model, which "reflects the particular characteristics of Pacific's embedded network . . . [and] does not accurately reflect the forward-looking cost of deploying loop plant.").

76 The carrier estimates that only 35 percent of "every additional line installed require new loop facilities" -- meaning that in 65 percent of the cases Pacific can use existing facilities. Pacific Comments, Exhibit A, at 19. This is because, historically, Pacific (like all of the ILECs) has deployed multiple lines to each residential subscriber. During the many years in which these lines went unused, Pacific incurred depreciation expenses while generating no new revenues. As a result, in two-out-of-three cases, when a customer orders a second line, Pacific is able to generate a stream of income from an existing, fully depreciated asset that had previously generated no revenue whatsoever.

77 See Implementation of the Local Competition Provisions of the Telecommunications Act of 1996, 11 FCC Rcd 15,499, 16,238 (1996), petition for review pending sub nom. Iowa Utilities Board v. FCC, No. 96-3321 (8th Cir.) ("Interconnection Order").

The Commission has determined that the TELRIC of local switching is between 0.2 to 0.4 cents per minute.[78] At this level, Pacific will generate net revenues from any second line provided to a customer who is on-line for less than 14.2 hours per month.[79] In fact, Pacific's comments indicate that the overwhelming majority of its Internet customers are on-line for less than 8.3 hours per month.[80] This suggests that, rather than losing money on customers that obtain second lines for Internet access service, Pacific is making a considerable sum.

This conclusion is consistent with Pacific's actual marketplace behavior. Pacific, like other ILECs, has been aggressively promoting the sale of second lines as a means to access the Internet. Indeed, it has been offering five months of free Internet service to any subscriber that orders a second line.[81] If Pacific were not making money on second lines used to access the Internet, it is difficult to see why it would affirmatively encourage consumers to obtain second lines for this very purpose.

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78 See id. at 15,905.

79 The difference between Pacific's monthly charge of $14.50 and the $11.10 TELRIC cost of the loop is $3.40. At 0.4 cents per minute, a caller would need to be on-line for 875 minutes (14.2 hours) per month to impose $3.40 worth of costs on the network.

80 Pacific has stated that, if each Internet user were required to pay a one cent per minute charge, 80 percent of all users would pay charges of less than $5 per month. See Pacific Comments, Exhibit A, at 4. This means that these users are on-line for less than 8.3 hours (500 minutes) a month. (A charge of 1 cent per minute for 500 minutes yields $5.)

81 See ETI Study at 33.

## B. The Commission Should Not Impose the Anti-Competitive Regulatory Regime Advocated by Some of the ILECs

### 1. The Commission should not impose federal access charges on ESPs/ISPs

A number of commenters argue -- yet again -- that the Commission should require ESPs/ISPs to pay federal access charges.[82] While the details of the proposals vary, the proponents make three basic arguments. First, some parties contend that ESPs/ISPs should be required to pay the same access charges as interexchange carriers because they are "identical to interexchange carriers . . . in terms of their interconnection with and use of the PSTN."[83] Other parties contend that imposition of a federal access regime is appropriate because the traffic that is delivered to ESPs/ISPs is jurisdictionally interstate.[84] Finally, several parties assert that ESPs/ISPs should be required to pay access charges in order to create an "incentive" for them to move their traffic off the PSTN and onto more efficient data-oriented packet networks.[85] These contentions are without merit.

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82 The question of whether ESPs/ISPs should be subject to federal access charges was directly presented in the Notice of Proposed Rulemaking concerning access charges. At that time, the Commission tentatively concluded that these charges should not be imposed on ESPs/ISPs. See Access Charge Reform, Price Cap Performance Review for Local Exchange Carriers, Notice of Proposed Rulemaking, CC Docket No. 92-262, at ¶ 288 (rel. Dec. 24, 1996). All parties had an ample opportunity to challenge this conclusion in the access charges rulemaking. The Commission should look with disfavor on efforts to use this Inquiry to reargue the issue.

83 ACTA Comments at 4; see USTA Comments at 15.

84 See U S West Comments at 8, 22; USTA Comments at 2; AT&T Comments at 28; GTE Comments at 31.

85 See Pacific Comments at 33-35; Bell Atlantic/NYNEX Comments at 12; SWBT Comments at 4; U S West Comments at 26; USTA Comments at 8.

**ESPs/ISPs do not use the PSTN for the same purpose as IXCs.** ESPs/ISPs are not carriers. While an IXC uses local exchange networks to originate and terminate long-distance voice traffic carried over its network, an ESP/ISP uses local exchange networks to receive local data traffic from its customers.[86] These providers often pass that traffic on to other data service providers, such as the entities that operate the Internet backbone.

Internet and other enhanced service providers neither want nor need many of the voice-oriented features that the ILECs have bundled into their interstate access arrangements, such as "equal access" dialing and trunk-side signalling.[87] Consequently, the Commission should not require ESPs/ISPs to pay the same carrier access charges as IXCs -- regardless of whether carrier access charges remain at their current inflated level or are brought closer to cost.[88] Whatever the price, ESPs/ISPs should not have to pay for voice-oriented network features that, in a competitive market, they would not choose to purchase.

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86 See Internet Access Coalition Comments, CC Docket No. 96-262, at 10 (filed Jan. 29, 1997); ETI Study at 17.

87 See Comments of Juno Online Services at 10 ("ESPs are not interconnected to LEC networks like long-distance carriers . . . and generally do not need features associated with carrier access services, such as 'equal access' long distance dialing, trunk side signaling and other voice-oriented functionalities. In a very real sense, imposing access charges on ESPs would unlawfully force ESPs to pay for services that they do not want or use."); see also OPP Working Paper at 62 ("Access charges have been structured based on the features and service bundles used by IXCs to handle voice calls, which may be different than those ISPs would choose.").

88 See Teleport Comments at 3 (explaining that imposition of carrier access charges on ESPs/ISPs would be inappropriate "because [ESPs/ISPS] do not receive any benefit from the type of access services used by interexchange carriers.").

**The Commission should continue to allow ESPs/ISPs to obtain access using state-tariffed lines.** Several parties assert the traffic received by Internet and other enhanced service providers is jurisdictionally interstate. Therefore, they contend, the Commission should require ESPs/ISPs to use federally tariffed access arrangements to receive this traffic.[89] The Commission should decline to do so.

The Commission's decision to allow ESPs/ISPs to use state-tariffed access arrangements to connect to the PSTN is legally sound. As the Coalition previously has explained, ESPs/ISPs use the local exchange network in a manner that is similar to many other business customers.[90] To be sure, ESPs/ISPs typically use business lines solely to receive incoming calls. Some of this traffic, moreover, plainly is routed onto ESPs/ISPs' interstate private networks or to out-of-state servers over the Internet. A significant number of other users, however, have traffic that displays precisely the same characteristics.[91] Yet, it has never

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89 See U S West Comments at 8, 22; USTA Comments at 2; AT&T Comments at 28; GTE Comments at 31.

90 See Coalition NPRM Comments at 17-18; ETI Study at 18; Juno Online Services Comments at 3 ("There are a variety of other business line users -- including ticket agencies, credit card validation services, airline reservation services, catalog merchants and the like -- whose 'inbound' usage of the local telephone network is similar to ESPs.").

91 For example, business customers such as call centers, mail order providers, and financial institutions often receive substantial volumes of incoming traffic without generating any corresponding outbound traffic.

been doubted that such firms are allowed to connect to the PSTN using state-tariffed business lines.[92]

**ESPs/ISPs have strong competitive incentives to use efficient access arrangements.** The principal argument advanced by the commenters that ask the Commission to impose federal access charges on ESPs/ISPs, is that doing so is necessary to provide ESPs/ISPs with an "incentive" to migrate their traffic from the circuit-switched network to more appropriate access arrangements.[93] As long as ESPs/ISPs are able to use low-cost state business lines, these parties contend, they will continue to send traffic over the PSTN, rather than using more efficient technology.

This argument rests on a faulty premise. ESPs/ISPs do not use the PSTN because it is "the cheapest game in town." They do so because it is "the only game in town." ESPs/ISPs know that their customers want high-speed access to the Internet and other on-line services; they have strong competitive incentives to obtain the data communications services necessary to satisfy this demand. Until very recently, however, ESPs/ISPs simply have had no

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92 As Pacific recognizes, the Commission previously has ruled that ILECs cannot impose restrictions on the ability of an ESP to obtain state-tariffed business line service in the same manner as other business customers. See Pacific Comments at 19 n.26.

93 See AT&T comments at 21; Pacific Comments at 33-35; Bell Atlantic/NYNEX Comments at 12; SWBT Comments at 4; U S West Comments at 26; USTA Comments at 8.

choice but to connect to their customers using the ILECs' voice-oriented, circuit-switched networks.[94] As the Internet Users' Coalition perceptively observes:

> The notion that new charges are necessary to motivate ISPs to improve their facilities is based on an inaccurate portrayal of the Internet industry, because it ignores the preferences of Internet users. It assumes that, much the same as the local telephony market, the information services market is not competitive. This misconception leads the ILECs to conclude that ISPs will fail to act unless there are regulatory incentives. But this is not the case; the ISP market is presently highly competitive. There is every indication that users who want more data-friendly networks and/or less congestion will demand it, and will vote with their feet . . . . Therefore, an ISP already has a powerful, direct economic incentive to adopt more efficient service.[95]

Where alternatives are available, ESPs/ISPs have demonstrated that they will use appropriate technology -- even if they must pay higher prices. For example, Bell Atlantic's most recent study finds that demand by ISPs in its region for more expensive "trunk-side connections . . . now exceeds the demand for line side connections."[96] Demand presumably would be greater still if Bell Atlantic were to eliminate the economic disincentives to the use of trunk-side

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94 See MCI comments at 12 ("The incumbent LECs' record in the provision of advanced services is dismal. For example, the incumbent LECs have introduced ISDN services only slowly or at prohibitive rates . . . .").

95 Internet User Coalition Comments at 11; see CIX comments at 3 (The "Internet service industry is going through a period of steep competition, rapid change and consolidation . . . . In such a competitive environment, the industry will have every economic incentive to make use of efficient high bandwidth access arrangements that improve the value of the ISP's service to the customer.").

96 Bell Atlantic/NYNEX Comments, Attachment B, at 4.

connections.[97] This was the case when Pacific brought prices for primary-rate ISDN more into line with costs. Indeed, at the present time, there is still a significant backlog of orders for such connections.[98]

The suggestion, made by several of the ILECs, that ISPs have refused to subscribe to available packet-switched services that would take data traffic off the PSTN is simply untrue.[99] Contrary to the ILECs' assertions, many of these offerings do not take data traffic off the PSTN. Bell Atlantic's IPRS service, for example, requires end-users to send data traffic over the local loop to the same end-office as they send their voice traffic. At the end-office, the customers' data traffic passes through the same circuit switch as their voice traffic. It is then routed over the same trunk lines as the customers' voice traffic, until it reaches one of Bell Atlantic's data aggregation hubs. It is only at that point that the traffic is routed onto a packet-based network and transported to the ESPs/ISPs' premises.

This configuration provides no new efficiencies. Indeed, the only difference between this arrangement and the configuration typically used today is that data traffic is aggregated at Bell Atlantic's hubs, rather than the ESPs/ISPs' premises. If anything, this

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97 According to Bell Atlantic's own statistics, while the per-channel cost of a trunk-side connections is 33 percent less than the per-channel cost of a line-side connection, the per-channel price of a trunk-side connection is 15 percent higher than a line-side connection. See id. at 1.

98 See Pacific Comments at 31 n.42.

99 See, e.g., id. at 13. The first time some members of the Coalition became aware of these services is when the carriers contacted their government affairs officers in the weeks prior to filing their NOI comments. The Coalition is not aware of any attempt to market these offerings through the normal commercial channels.

approach is a step backwards: it allows Bell Atlantic to foreclose competing data communications providers from "splitting off" data traffic at the originating end-office and providing their own aggregation and transport services.[100]

The data service described by Southwestern Bell in its comments could provide a more suitable means of moving data traffic off the PSTN.[101] This service would use Nortel's Internet Thruway™ to separate data traffic at the originating end-office, and divert it to a carrier-operated frame relay network, which would deliver the traffic to the subscriber's ESP/ISP. SWBT's comments, however, provide no information regarding the price and performance characteristics of this proposed solution. A review of a SWBT-filed tariff indicates that the carrier proposes to charge end-users approximately $108 a month for this service, while not providing them with significantly higher data rates than they receive using the PSTN. Such an offering plainly does not constitute ubiquitous deployment to consumers of affordable, efficient data communications services.[102]

There is no reason to believe that ILECs would be "more motivated" to deploy affordable and efficient data communications services if ESPs/ISPs are required to pay access

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100 The proposed data transport service described by NYNEX apparently suffers from the same defects.

101 See SWBT Comments at 6, 7.

102 Indeed, for virtually all customers, use of the PSTN would be a far more efficient alternative -- even if access charges were imposed. For example, even if the Commission were to adopt Pacific's proposal to impose a one cent per minute ESP access charge, a customer would have to stay on line for 180 hours per month before it became economically rational to subscribe to SWBT's frame-relay-based service.

charges.[103] To the contrary, as CompuServe and Prodigy make clear, "[a]s long as the incumbent local telephone companies retain their dominant market power in the local marketplace, they will lack the incentive to upgrade their existing circuit-switched networks to provide a more data-friendly fast packet network environment more suitable for carrying enhanced services traffic."[104] Indeed, given the significant new source of revenue that would be created by imposing per-minute access charges on ESPs/ISPs, there is every reason to assume that the ILECs would continue to invest in the current circuit-switched infrastructure. Moreover, the ILECs' ability to impose these charges on competing ESPs/ISPs could allow the incumbents to obtain an unfair competitive advantage as they enter the information services market.[105]

**Any federal rate for ESPs/ISPs should be optional, cost-based, and limited to new technology.** As demonstrated above, there are strong legal and policy reasons for the Commission to continue to allow ESPs/ISPs to continue to use state-tariffed access arrangements.

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103 Pacific Comments, Exhibit A, at 26. This argument, MCI correctly observes, "turn[s] the notion of the competitive market on its head. . . . Where competitive companies see the increased demand for enhanced services as a meaningful revenue opportunity worthy of new investment, the [incumbent carriers] want the money up-front and will decide later whether to make the investments or not." MCI Comments at 3.

104 CompuServe/Prodigy Comments at 8; see also GSA/DOD Comments at 10 ("[T]here is no way to ensure that revenues generated from a hypothetical access charge would be used to invest in a network that can accommodate more traffic.").

105 See Internet Consumer Parties Comments at 15 ("A plausible explanation for the LECs' position is that it is calculated to drive the ISPs out of the market, thus allowing the LECs to capture the market for themselves . . . . ISPs are in a precarious position as relatively small competitors to the far larger LECs; if discriminatory practices such as imposing access fees are allowed, these businesses will stand no chance of competing in this market."); Internet User Coalition Comments at 15 (Imposing access charges on ESPs/ISPs would give "an ILEC's ISP business unit . . . an unfair advantage over unaffiliated or entrepreneurial competitors.").

If, notwithstanding the above, the Commission concludes that a federal rate structure would be appropriate, any federal rate structure should be optional, cost-based, and should apply only to new "data friendly" services.[106]

### 2. The Commission should maintain the remaining protections against supra-competitive pricing

Several of the ILECs ask the Commission to grant them "pricing flexibility" in order to provide them with sufficient incentives to deploy new technology and services.[107] The Commission should reject this request.

As the Coalition explained in its comments, the Commission already has taken significant steps to create incentives for the ILECs to deploy more efficient technology by replacing traditional rate-of-return regulation with price caps.[108] The Commission has noted that, "by replicating many of the effects of competition," its price caps rules seek to "encourage

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106 This approach is somewhat similar to the suggestion, made in the recent working paper issued by the Commission's Office of Plans and Policy, that the Commission create a federal rate structure for ESPs/ISPs, but that application of this structure be "conditioned . . . on LEC commitments to build out data networks in a specified time frame." OPP Working Paper at 64. While the OPP proposal is an important contribution, the Coalition believes that it would be preferable to require the ILECs deploy new "data friendly" facilities and services before allowing them to implement any such rate structure. This will provide increased incentives for the carriers to deploy new technology, while ensuring that the Commission has a full understanding of the relevant costs as it develops the appropriate rate structures.

107 Pacific Comments at 7 ("[T]he Commission should allow all data access providers to have pricing flexibility . . . ."); SWBT Comments at 3, 6.

108 See Coalition Comments at 55.

the LECs to modernize their networks, deploy new technologies, and offer new services."[109] In particular, the Commission has explained that its price cap rules for new services are intended "to provide the LECs with the flexibility to price efficiently and the incentive to innovate."[110]

Despite these incentives, the ILECs have not assumed the risk of deploying new technology and services.[111] Permitting the LECs further flexibility would only allow them to reap supra-competitive profits on existing voice-oriented services, with no guarantee that these revenues would be used to deploy the broadband service needed by consumers to make effective use of the Internet and other information services. Thus, as CompuServe and Prodigy recognized, "[u]ntil effective competition develops in the local exchange marketplace, the Commission will need to exercise active regulatory oversight over the LECs to ensure cost-based rates."[112] Only when effective competition is firmly established, will it be appropriate for the Commission to eliminate its regulation of the ILECs' pricing practices.

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109 Price Cap Performance Review for Local Exchange Carriers, 9 FCC Rcd 1687, 1692 (1994).

110 Price Cap Performance Review for Local Exchange Carriers, 10 FCC Rcd 8961, 9142 (1995).

111 See Coalition Comments at 23; MCI Comments at 12 ("The incumbent LECs' record in the provision of advanced services is dismal. For example, the incumbent LECs have introduced ISDN services only slowly or at prohibitive rates and have largely abandoned their plans to deploy hybrid fiber-coax. . . . "); Internet Consumer Parties Comments at 11 ("In reality the LECs' relatively cavalier approach to alternative Internet access technologies, although now beginning to change, has for years suppressed demand for a more efficient service which could help alleviate LEC switch congestion.").

112 CompuServe/Prodigy Comments at 12; see WorldCom Comments at 8.

### 3. The Commission should not prevent CLECs from obtaining reciprocal compensation

Competitive Local Exchange Carriers ("CLECs") have been providing valuable data communications services. In some markets, for example, they have been acting as aggregators, allowing data traffic to be taken off the PSTN and delivered to ESPs/ISPs over efficient packet networks.[113] Several of the ILECs object to the fact that, in these situations, they must pay "reciprocal compensation" to the CLECs for terminating ILEC-originated traffic.[114] They ask the Commission to alter its regulatory regime so that they are not required to do so. The Commission should decline to do so. Depriving CLECs of termination revenue would plainly make it more difficult for them to meet the telecommunications needs of ESPs/ISPs. This, in turn, would slow the Commission's effort to facilitate "the deployment of services and facilities [that will] allow more efficient transport of data traffic to and from end users."[115]

There is nothing inappropriate about an ILEC sharing a portion of its "collection" revenue with the carrier that terminates a call that originates in the ILEC's network. Indeed, the ILECs' themselves have insisted on the use of reciprocal compensation agreements, and vigorously opposed CLECs that proposed "bill and keep" arrangements -- under which each

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113 See USIPA Comments at 10.

114 See Pacific Comments at 22; U S West Comments at 28; GTE Comments at 33; SNET Comments at 4,7.

115 Notice at ¶ 313; see MCI Comments at 10 ("[O]nly competition in the local exchange market can ensure that the most efficient technologies are deployed and offered at prices attractive to ISPs.").

carrier would keep all of its collection revenue.[116] The ILEC's presumably believe that, on balance, they will receive more traffic and thus more termination payments from CLECs. Having obtained the regulatory regime of their choosing, the ILECs cannot object to the fact that, in some instances, it may not work to their advantage.[117]

### 4. The Commission should not subject protocol conversion to Title II regulation

BellSouth has chosen to use this proceeding to make yet another attempt to get the Commission to impose common carrier regulation on protocol conversion. It claims that, in order to provide packet service from the central office to ESPs/ISPs' premises, it must be allowed to provide end-to-end protocol conversion as part of its regulated transmission service offering.[118] The Commission should reject BellSouth's request.

Since Computer II, the Commission has repeatedly found that end-to-end protocol conversion is an enhanced service, which must be provided on a non-regulated basis. The Commission reiterated this conclusion only a few months ago.[119] As the Commission has recognized, classifying protocol conversion as a non-regulated offering has yielded substantial

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116 See Interconnection Order, 11 FCC Rcd at 16,046-54.

117 The terms of any reciprocal compensation agreement are the result of negotiations between the ILECs and CLECs. If they are concerned about the revenue they are paying to CLECs, the ILECs plainly have the ability to negotiate lower termination charges.

118 See BellSouth Comments at 6.

119 See Implementation of the Non-Accounting Safeguards of Sections 271 and 272 of the Communications Act of 1934, as amended, CC Docket No. 96-149, FCC 96-489, at ¶ 104 (rel. Dec. 24, 1996) ("BOC Non-Accounting Safeguards Order").

benefits.[120] Indeed, this approach provides the foundation for the non-regulated status of the Internet and other packet networks.

Consistent with the Commission's rules, the BOCs have been providing both packet services and protocol conversion services to their customers for years. In light of this fact, BellSouth's unsupported assertion that continued compliance with these rules would somehow render its service offering "unacceptable" to ESPs/ISPs seeking an efficient means to communicate with their customers is entirely unpersuasive. Equally unconvincing is BellSouth's claim that providing protocol processing as part of its regulated transmission offering "would contribute to the achievement of the goals of the Telecommunications Act."[121] To the contrary, this approach would result in the regulation of protocol conversion offerings that have long been provided as non-regulated enhanced services. This result, the Commission has expressly recognized, would be inconsistent with "Congress's deregulatory intent in enacting the 1996 Act."[122]

### 5. The Commission should not impose common carrier regulation on Internet telephony

Only a handful of parties responded to the Commission's request for comments regarding the regulatory status of Internet telephony. Significantly, none of the commenters disputed the Coalition's conclusion that Internet telephony is not causing network congestion. Nor did any of the commenters demonstrate that the growth of "voice over the Net" services is

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120 See id.

121 BellSouth Comments at 7.

122 BOC Non-Accounting Safeguards Order at ¶ 105.

having any other adverse effects on users of the PSTN. Nonetheless, several commenters suggested that the Commission should impose some form of common carrier regulation on entities that provide Internet telephony.

ACTA and SWBT take the most extreme position: they contend that Internet telephony "is indistinguishable from regular telephony."[123] These parties insist that the Commission must impose the full measure of Title II regulation on any entity that provides this service. The Telecommunications Resellers Association ("TRA") and AT&T propose, somewhat more modestly, that the Commission impose carrier access charges (but not, apparently, other forms of Title II regulation) on providers of Internet telephony. In their view, voice over the Net services "are less expensive [than PSTN-based interexchange services] solely by virtue of . . . the ESP exemption, not because of any technological advances or business acumen."[124] This, AT&T adds, is causing a migration of voice traffic from the PSTN to the Internet.[125] The Commission should not be misled by these arguments.

ACTA and SWBT are simply wrong to suggest that Internet telephony is "indistinguishable" from interexchange telephone service. As the Coalition demonstrated in its initial comments, a PC user that employs software to send a voice message to another PC user is exercising his or her well-established right to connect CPE to the network. This activity bears

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123 SWBT Comments at 13; see ACTA Comments at 9 (Entities that "sell, market and advertise the ability to place telephone calls over the internet are providing the same telecommunication service . . . [as] the rest of the IXC community.").

124 TRA Comments at 15.

125 See AT&T Comments at 23-25.

virtually no resemblance to a common carrier that holds itself out to the public to provide interexchange service.[126] Similarly, many Internet telephony gateway operators provide users with the ability to interact with a data base that provides information about other users interested in receiving voice calls. There is nothing anomalous about not imposing Title II regulation on entities that provide this type of information service, while applying such regulation to entities that transport voice traffic.

Contrary to TRA's assertion, the growth of Internet telephony is not solely the result of a "regulatory quirk."[127] As a recent working paper released by the Commission's Office of Plans and Policy observed, "Internet telephony is . . . technically different from long distance voice calling." While a circuit-switched long distance call ties up a 56 kbps channel between the caller and the recipient for the duration of the call, digital compression and packetization allow voice traffic to be sent over the Internet in "bursts" that may consume far less bandwidth.[128] A significant portion of the growth of Internet telephony reflects the fact that the current regulatory structure allows consumers to realize the benefits of packet-switched technology. Calls to impose carrier access charges on Internet telephony are, in large measure, pleas by incumbent providers for the government to protect them from more efficient competitors.

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126 See Coalition Comments at 60, 61.

127 TRA Comments at 15.

128 See OPP Working Paper at 39. Internet telephony provides additional efficiencies in those cases in which customers, such as large corporate users, access the Internet over dedicated circuits.

The OPP working paper observes that services such as Internet telephony may "create legal headaches" for government regulators. However, the paper also recognizes that the growth of such services is a "positive [development] that government should encourage" because they provide new options for consumers, while exerting "competitive pressure . . . on incumbent providers."[129] Indeed, for that very reason, the Commission's International Bureau has expressly endorsed the growth of Internet telephony as a means to put downward pressure on international settlement rates charged by foreign monopoly carriers.[130] In light of the significant pro-competitive benefits provided by the growth of Internet telephony, the OPP working paper correctly concludes that the Commission's "initial assumption ought to be that new Internet-based services" -- including Internet telephony -- "should not be subject to the regulatory constraints of traditional services."[131]

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129 Id. at 47.

130 See International Settlement Rates, Notice of Proposed Rulemaking, IB Docket No. 96-261, FCC 96-484, at ¶¶ 13, 60 (rel. Dec. 19, 1996); Policy Statement on International Accounting Rate Reform, 11 FCC Rcd 3146, 3148 (1996) (affirming the FCC's commitment to alternative services that place downward pressure on accounting rates).

131 OPP Working Paper at 47.

## CONCLUSION

As the comments filed by the Coalition and others demonstrate, the further development of Internet and other information services can provide significant benefits to the public. This will only be possible, however, if users have affordable, high-speed access to these on-line services. The best means for the Commission to ensure that they do is to facilitate competition in the data services market. The Coalition urges the Commission to promptly issue a Notice of Proposed Rulemaking in which it is to propose rules, modelled on those advocated in the Coalition's comments, necessary to allow competitive entry into the wireline data communications market.

Respectfully submitted,

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